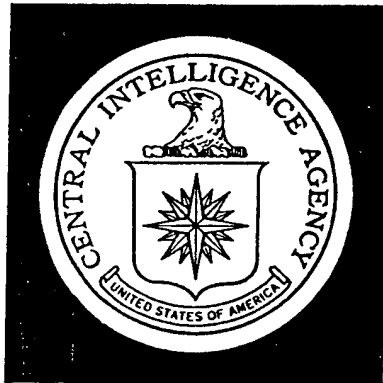


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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

*Economic and Military Implications
of the New Soviet Plan*

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No. 192877/17

CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence

INTELLIGENCE MEMORANDUM

Military and Economic Implications
of the New Soviet Plan

Summary

Recent Soviet plan and budget announcements, which call for a rise of 2.2 billion rubles in defense expenditures in 1968, almost certainly reflect an important change in economic priorities in favor of the military establishment. An analysis of the available evidence suggests that military and space outlays will grow by a substantial amount in real terms as a result of increases in many programs. However, accounting changes, higher prices for military goods, and perhaps military pay increases could also play a role; in combination these might exceed a billion rubles but are judged likely to fall short of one-half billion rubles in 1968. The diversion of additional funds to military purposes will force a slowdown in agricultural and industrial investment. Thereby, the USSR is risking the long-term technological quality of its industrial plant and making future agricultural gains more precarious (see Figure 1).

No single Soviet military program is susceptible -- except under extraordinary crash conditions -- to changes in magnitude that would account for a major portion of the announced 2.2 billion rubles. The largest military programs

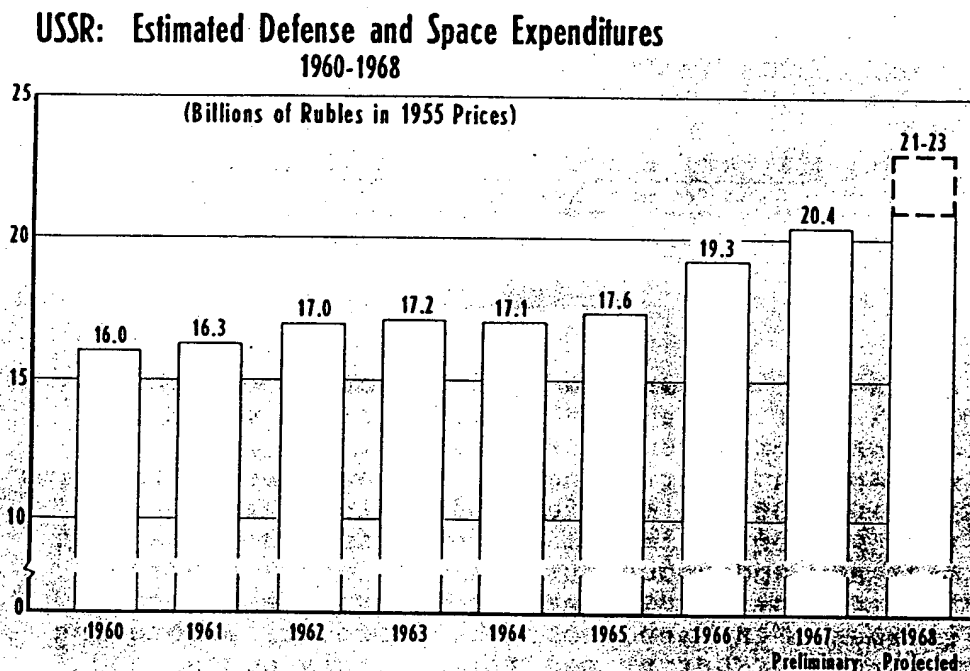
Note: This memorandum was produced by CIA. It was prepared by the Office of Economic Research with contributions from the Office of Strategic Research and the Office of Current Intelligence. This memorandum was coordinated with the production offices of the Directorate of Intelligence and represents the best judgment of the Directorate as of October 1967.

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Figure 1



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under way in the USSR in 1967 are those for deployment of the SS-9 and SS-11 ICBM's, which are at an estimated combined annual spending level of 1.7 billion rubles. All other individual Soviet military programs require much smaller expenditures.* However, improvements in the readiness and mobility of general-purpose forces could require the expenditure of one-half billion rubles or more in the next year. If actual military spending in 1968 were to rise by the announced 2.2 billion rubles, it would almost certainly be a compound of increases in several major programs.

The present political, military, and economic climate in the USSR is favorable to a further shift in resource allocation priorities. The

* Estimates for 1967 outlays on the ABM system being deployed at Moscow are at a level of about 100 million rubles; the deployment program for the Tallinn defensive system, about 200 million rubles; nuclear ballistic-missile submarines, about 140 million rubles; and air defense fighter aircraft procurement, about 200 million rubles.

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re-equipping of Arab nations in the Middle East, the desire to increase aid to North Vietnam and the uncertainties created by that conflict, and the plan to strengthen defenses because of the Chinese problem are all developments that bolster the arguments of the Soviet military leadership for a larger share of the budget. The recent announcement of US intentions to deploy a thin ABM screen, we believe, has not yet been fully digested in the thinking of top Soviet policymakers, nor reflected in the budget announcement, but this development also strengthens the hand of the military spending advocates.

As for the economic climate, recent developments in both agriculture and industry appear to have strengthened the Soviet economy. Two favorable harvest years have reduced the urgency for doubling agricultural investment along the lines of the Brezhnev program and have eliminated for the time being the necessity of large imports of wheat. Industrial production, bolstered by gains in military output and productivity, continues to grow at a rapid 8 percent a year in spite of continued difficulties in commissioning new plants and getting operations up to rated capacity (see Figures 2 and 3). Finally, in terms of both real and monetary income, the consumer has enjoyed very good years in 1966-67, with the notable exception of housing.

An examination of available data indicates that the rise in Soviet military spending will have its largest immediate impact on (a) investment in modern industrial facilities, (b) production of nonmilitary industrial goods, and (c) investment in agriculture. No data were announced on plans for the production of industrial equipment and military equipment for 1968-70, but the data for 1966-67 -- when military spending was also rising rapidly -- are illuminating. Production of equipment for investment increased at an average rate of only 5 percent in 1966-67, compared with 10 percent in 1961-65. Deliveries of military equipment rose an average of 11 percent in 1966-67, compared with 3½ percent in 1961-65. In the case of nonmilitary goods, the original 1970 goals are being either trimmed (natural gas, electric power,

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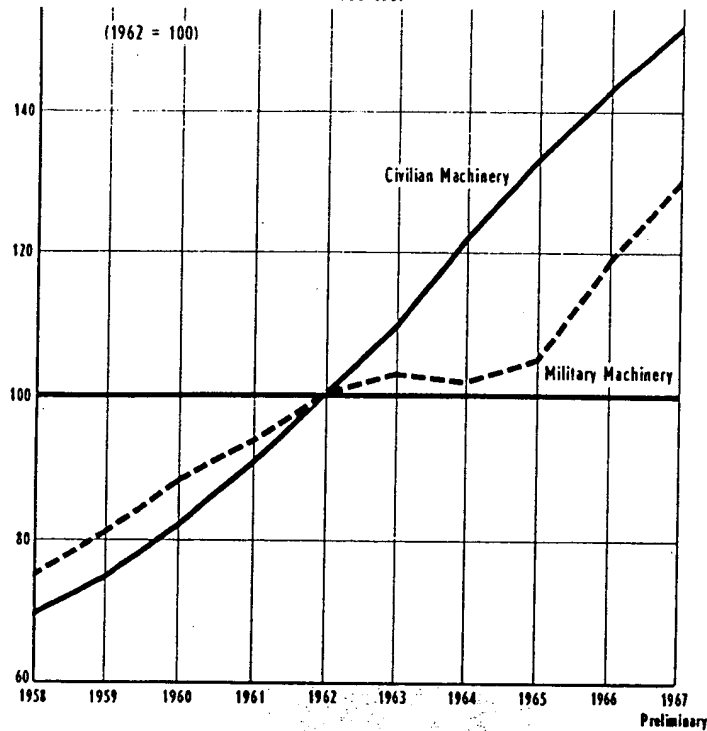
plastics and resins, and chemical fibers) or set at the low end of the range announced by Kosygin in 1966 (steel, motor vehicles, and fertilizer). The plan for a doubling of agricultural investment is being cut back, especially the plans for agricultural machinery.

The slowdown in the flow of new industrial investment will force the USSR to operate an industrial plant that is growing older and more obsolescent. Therefore (a) technology will lag, (b) repair bills will mount, and (c) a growing fraction of output will be below Western standards. In agriculture, the lack of a sustained investment program probably will mean the failure to meet the ambitious goals for 1970, which, if realized, would have permitted the USSR to once more export grain in quantity. The consumer also will feel the effect of the change in economic priorities. The promised increases in wages, pensions, and other benefits will mean sizable increases in money income, but these increases are not likely to be paralleled by similar increases in real goods. Housing and construction of new capacity in consumer goods industries are especially vulnerable when the pressure on resources mounts.

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Figure 2

USSR: Indexes of Production of Civilian and Military Machinery 1958-1967

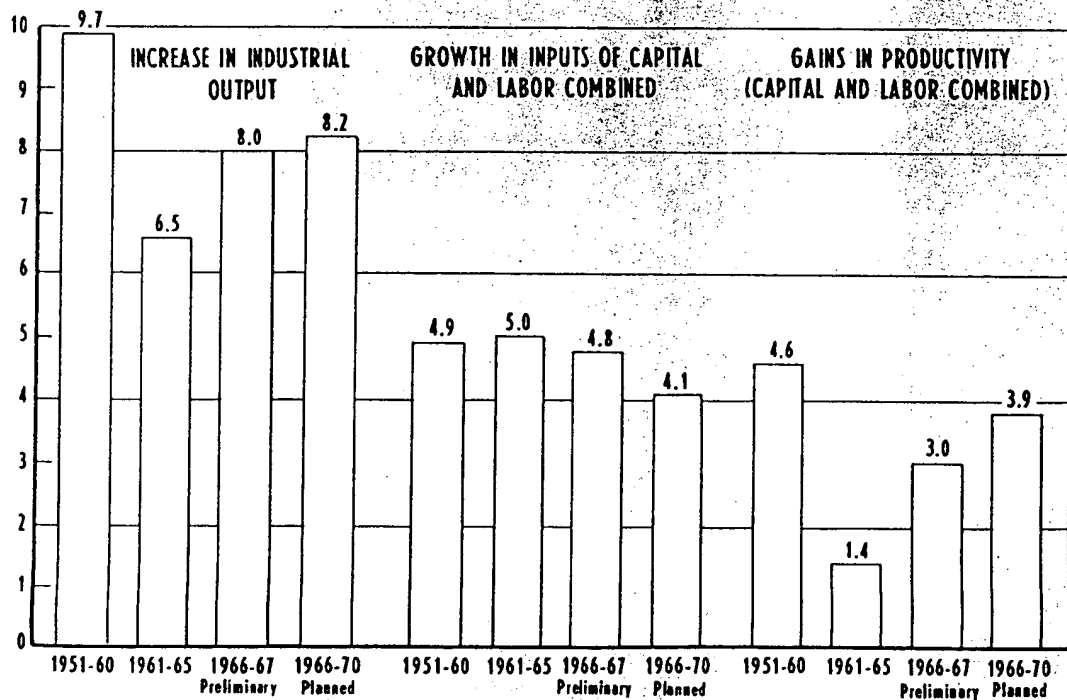


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Figure 3

USSR: Growth of Industrial Output, Capital and Labor, and Productivity 1951-1970 (Average annual rates in percent)



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INTRODUCTION

1. On 10 October 1967, Nikolay K. Baybakov, the Deputy Chairman of the Soviet Council of Ministers and Chairman of Gosplan, addressed the Supreme Soviet on the state economic plan for 1968 and on preliminary plans for 1968-70. On the same date the Minister of Finance, Vasiliy F. Garbuzov, reported on the USSR State Budget for 1968 and the implementation of the budget for 1967. It is believed that these plan and budget announcements, although lacking detail, signaled an important change in Soviet economic priorities in favor of the military establishment. The most important single figure to appear was a planned increase in defense expenditures for 1968 of 2.2 billion rubles.

2. The annual plan and budget speeches traditionally offer the most authoritative description of Soviet economic policy. Indeed, in many key areas, very little is published later to supplement the information contained in these two basic statements. The uncertainty surrounding military programs in the plan and budget speeches is always great. It is known that the overt defense budget does not cover all Soviet military outlays; it is also known that the degree of coverage has varied over time because of shifts in accounting practices.

3. In mid-1961, for example, Premier Khrushchev suddenly announced that expenditures for defense would be increased to 12.4 billion rubles in 1961, instead of the planned 9.3 billion rubles announced the December before. His statement followed hard on the announcement by President Kennedy of a substantial boost in the US military budget. Much of the announced Soviet increase in 1961 appears to have been spurious -- actual outlays were later reported as only 11.6 billion rubles, and there was strong evidence of a transfer to the defense category of defense-related expenditures from other categories of the budget. Nevertheless, whenever the USSR announces a substantial jump in military spending in an atmosphere of military and political tension, as it did this October, the announcement is a clear political signal and almost certainly means that some shift in resources in favor of military programs is actually planned.

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POLITICAL CONSIDERATIONS

4. Three important political factors bear on the plan and budget announcements. Two of the factors involve the image that the USSR wishes to present to the world at this point in time, and they exist quite apart from the actual relationship between the announcements and the ultimate allocation of resources. The third factor concerns the hard political realities at the pinnacle of the leadership which determine the way in which economic (and all other) decisions are made.

5. Recent international developments have very likely increased the Soviet leaders' concern for the USSR's national security and hence the need to demonstrate a posture of strength and readiness. Some leaders may see the US ABM announcement as a sign that the arms race is about to enter a new and enormously more expensive phase which will tax Soviet resources but which the Soviet Union cannot avoid; however, there has not been sufficient time to digest the full impact of the US announcement.

6. Other leaders may be more concerned that the trend in "local wars," such as the war in Vietnam and the war between Israel and the Arab states, means that the United States has gone beyond "containment" and is trying to roll back revolutionary and socialist regimes. Finally, some may view the rapid development of Communist China's military might as carrying with it the prospect that the near future will see the USSR confronted by a hostile well-armed neighbor.

7. Individual Soviet leaders may differ on the nature and degree of the threat posed by these developments and on the best way of countering it. Some leaders have a far bleaker view of the world scene than others and would prefer to adopt a militant international stance and match the United States step-for-step on all of the arms fronts. Even those who would give higher priority to building up the USSR's internal strength and searching out areas of agreement with a potential enemy, however, would not wish to negotiate from apparent weakness. The result this summer and fall has been not only

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the announced increases in military spending but also such well-publicized activities as support for North Vietnam and the Arab states and the large-scale "Dnepr" military exercise. Moscow apparently has believed it to be necessary to add to the "strength" side of its desired image of "strength and reasonableness."

8. Another political factor influencing the shape of the recently announced economic plans and budgetary measures is the desire of the regime to draw attention, especially during its 50th Anniversary, to its ability to provide for the population's welfare while maintaining a high rate of economic growth. In part, this factor stems from the need to stimulate the enthusiasm of the populace for "building Communism" and thus obtaining its willing participation in economic development. It also stems from the need to prove to those who are determining the path of development in the emerging nations that "socialism" is a more progressive means by which to develop a nation's economy and improve its standard of living.

9. As in dealing with the international situation, individual leaders may differ over the emphasis they put on satisfying the immediate wants of the population as distinguished from investing for further economic growth. They may differ over priorities -- urban development or bringing 20th-century amenities to the rural areas, expanding facilities for education or for recreation. They may also differ over what methods will prove most successful -- increasing the purchasing power of the population or expanding the state-run welfare programs and facilities, spurring the growth of productivity by increasing investment in production facilities or by increasing the workers' pay, producing more and/or better goods or improving the means by which they are processed en route to the final consumer. Regardless of their individual motives and priority preferences, however, the USSR's political leaders do seem to agree that it is expedient from time to time to undertake measures and programs designed to better the life of the Soviet citizenry.

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10. The Soviet leaders thus appear to be in general agreement about these two broad problems -- the need to polish the image of the regime as a resolute defender of international "progress" and as a capable provider for the wants of its people. As noted, however, beneath this agreement on overall goals lie sharp differences about specific points which in turn necessitate the making of hard choices among the competing demands for Soviet resources. These demands are still resolved by compromise, not only between those leaders favoring more guns and those favoring more butter but also between those favoring different types of guns and between those preferring different brands of butter. This year the butter advocates did well, particularly those advocating an increase in disposable income and the stepped-up production of consumer goods to prevent inflation. However, the guns advocates also got a sizable increase, as the regime continues to show that it is more responsive than was Khrushchev to the views of the military hierarchy..

11. The provision of more guns and butter in the short run means that needed long-run investment in future capacity to produce guns and butter may be jeopardized. Thus present decisions on resource allocation may come back to haunt the leadership if long-term growth rates decline or if agricultural production stagnates. As the product of compromise acceptable to the collective leadership, the decisions probably fully satisfy none of the individual leaders; for this reason also it may be expected that if these decisions backfire they will become a subject of acrimonious disagreement.

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MILITARY CONSIDERATIONS

Potential Inflation of the Military Budget

12. Several factors may lead to an exaggeration of the increase in the real flow of goods and services to military uses in 1968. The one with the greatest potential effect is the general change in prices for military equipment and other commodities used directly or indirectly by the military, although in any event it is believed that this would be less than 500 million rubles. This change was part of an overall revision in Soviet wholesale prices that was completed on 1 July 1967.

13. Shifts in accounting practices probably explained a significant portion of increased defense budgets in 1961 and 1962. The opportunities for major bookkeeping adjustments are believed to be smaller today. One possible exception is the treatment of military assistance. It is not known whether military assistance is incorporated in the explicit defense budget. If military assistance previously has been carried outside the explicit defense budget, a reclassification of military assistance to North Vietnam and the Arab World might add as much as 500 million rubles to the budget.

14. Finally, a broad military pay increase in 1968 to parallel the wage increases for civilian workers could add 200 million to 300 million rubles to the budget. Although there is no evidence of such an increase, military pay has not been raised for many years and a pay hike would appear to be long overdue. Moreover, the reduction in conscription terms would intensify the problem of retaining skills in the military services and thus would increase the pressures for a pay raise and other incentives to reenlistment.

15. In summary, the total effects of higher prices, accounting shifts, and military pay increases potentially could exceed a billion rubles but are likely to fall short of a half-billion rubles.

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Recent Trends in Military Expenditures

16. Total Soviet spending for military and space programs will have increased in 1967 by almost 4 billion rubles above 1965 levels -- a marked change from the more stable level of spending under Khrushchev during 1962-65 (see Figure 4). Estimated expenditures in 1967 -- about 20 billion rubles -- are approximately 16 percent higher than the 1965 level and some 5 to 6 percent above the 1966 level. Expenditures for ICBM's will have doubled in the two years, and expenditures for SAM's and the ABM program will have increased 70 percent. On the basis of present estimates, expenditures for ICBM programs should peak in 1967 and thereafter (1968-70) decline somewhat.

17. The factors most likely to affect these projections would appear more likely to increase rather than to reduce them. The factors include the possibility that ICBM deployment, including qualitative improvements in present systems, would move to higher levels than now estimated. Similarly, in the case of the Moscow ABM system, a more rapid national deployment might occur than is now anticipated.

18. The trend of expenditures for the general-purpose forces and for command and general support has held at about 9 billion rubles from 1962 through 1967. Current projections show little or no change in the level of these expenditures in 1968, although developments in 1967 could have led the Soviet leaders to decisions for broad improvements in these forces.

Possible Areas of Increased Spending

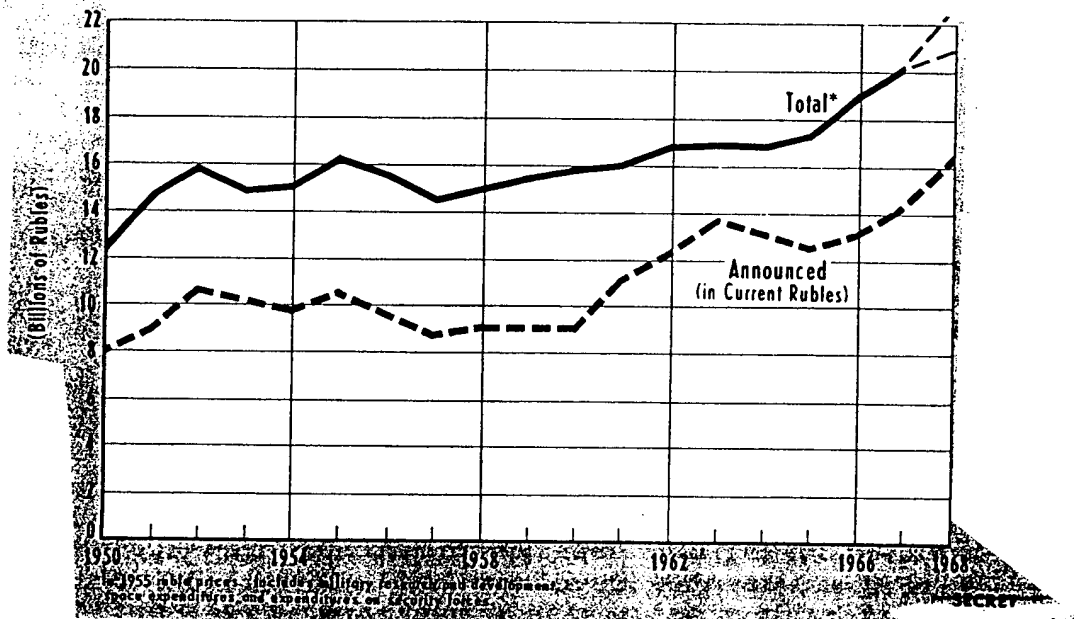
19. The increases announced for 1968 are 2.2 billion rubles for the defense budget and about a half-billion rubles estimated as the share of the increased science funds that is allocated to military R&D and space. After allowing for some possible price and accounting effects that would not call for additional programs or activities (discussed above), there would still seem to be some 1.5 billion rubles that could create real changes in military forces

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Figure 4

**USSR: Comparison of Announced Defense Budget
and Estimated Total Military and Space Expenditures
1950-1968**



and up to a 500-million-ruble real increase for military research and development and space efforts. The total amount -- approximately equivalent to \$4 billion to \$5 billion in military goods and services purchased in the United States -- is especially large when viewed as a further increment to the cost of the already expanded strategic system.

20. Direct evidence of new military programs or extensions of existing programs to higher levels than now estimated can neither strongly support nor convincingly argue against the prospect of significant real increases in defense spending to these levels. Discussions of possible programs are extremely speculative under such circumstances. The various alternatives discussed below should be

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considered only as illustrative examples of programs that the USSR could pursue which would place demands on the economy for the general magnitude of resources implied by this increase.

Strategic Programs

21. There are relatively few military programs under way in the USSR which are big enough in themselves to have major implications for overall Soviet military expenditures. The programs having the largest expenditures during 1967 were the SS-9 and SS-11 ICBM deployment programs, which combined were at a level of about 1.7 billion rubles. Expenditures for these programs had been expected to peak in 1967 and to decline by almost a billion rubles in 1968. Considerable uncertainty still exists about the status of these programs, however, and the sharp decline in expenditures referred to above either may not occur or may be much more moderate.

22. Each of the other programs required substantially smaller levels of expenditures. For example, estimated expenditures for the ABM system being deployed at Moscow were at a level of about 100 million rubles; the deployment program for the Tallinn system was at a level of 200 million rubles; nuclear ballistic-missile submarines were some 140 million rubles; and fighter aircraft procurement for air defense was at a level of about 200 million rubles. No one of these smaller programs is susceptible to changes that would make up a major part of the increase in announced defense expenditures, although several, such as the ABM, are expected to grow substantially in 1968. It is probable, therefore, that an overall increase of the magnitude which was announced would consist of increases in many programs.

23. Because all of these systems are now well along in their production cycle, they are reasonable candidates for either expansion or continuation of deployment rates beyond currently estimated levels. The ICBM programs alone, for example, could drive estimated total military outlays for 1968 upward by nearly a billion rubles if, instead of reduced expenditures implied by a falling off of deployment rates, the estimated rate of deployment

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of the past two years is maintained for another year or so. In contrast, the pace of deployment of the Tallinn system is believed to be already rapid and would have to be sharply accelerated in 1968, or the Moscow ABM system expanded into a broader deployment program, for these systems to affect 1968 expenditures significantly. Either of the above two programs could require as much as an additional one-quarter billion rubles in such circumstances.

General-Purpose Forces and Command and General-Support Programs

24. Pressures have existed for a number of years for upgrading the capabilities of the general-purpose forces and the command and general-support establishment to enable the USSR to exploit its strategic position more fully through the exercise or show of force at substrategic combat levels. These pressures appear to have been held carefully in check up to now as a result of the costs of developing and expanding the deployment of strategic systems.

25. Any general loosening of the restraints on military spending would release pent-up demands of several years standing. The requirements would extend throughout many program areas and in the aggregate could generate substantial expenditures in the relatively short run. The increasing conflicts of interest in the Middle East and the growing Soviet apprehension about Asia related to the Vietnam War and the Sino-Soviet dispute are probably strengthening the arguments of the proponents of improved general-purpose forces.

26. Total annual expenditures for the general-purpose forces were relatively stable at about 6 billion rubles during the 1960's. There has, however, been considerable fluctuation in the levels of the force elements and weapons systems programs that has tended to be offsetting. A determination to upgrade general-purpose force capabilities significantly and rapidly -- for example, to improve force mobility or limited war potential -- could alter the pattern of general stability and increase total expenditures by some one-half billion

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to a billion rubles, depending on the intensity of the effort.

27. There are several different types of programs that could contribute to such an increase. If, for example, 200,000 men were added to the ground forces, expenditures would be raised by roughly 200 million rubles. An increase of about 300 million rubles could be generated by a decision that the mobility, fire-power, and tactical air support of the ground troops should be quickly augmented -- bringing expenditures for these programs to about 3.8 billion rubles. Similarly, a speedup in the introduction of new transport aircraft could raise outlays in 1968 by about 100 million rubles above the 1967 level of about 500 million rubles. Combined improvements in the surface fleet, the naval air arm, and the submarine attack forces would require some 200 million rubles more in 1968 than in 1967.

Increased Operational Activity

28. The top Soviet leadership this summer has showed increasing concern for the level of readiness of the armed forces. This concern already has generated increased operating and maintenance costs. In a speech to military graduates in July 1967, Brezhnev stressed the need for increased readiness, and this was followed by a conference of military district commanders which stressed preparedness. In the same month, there was a major strategic exercise that involved combined forces. In September 1967, there was another massive military exercise (Dnepr) in the western USSR. Some troop units have been moved toward the Chinese border, and naval units have been moved into the Mediterranean. Other indications of increased alert status and operational readiness suggest that POL and logistics consumption have been increasing. It is calculated that some 200 million rubles might be required per year for these operational support activities.

Military Research and Development and Space

29. Soviet expenditures for science in the fields of military weapons and space have climbed

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steadily over the years, roughly paralleling trends in the United States. Since the early 1960's, there has been evidence of increased concern for the large annual increments for science, and efforts have been pushed for greater cost-effectiveness -- more research per ruble. Some decline in the rate of growth has occurred recently -- a trend which was reversed by the announced increases for 1968. Because of the diffused nature of science in the Soviet economy and because of the lag between program initiation and intelligence detection of programs, identification of specific new scientific projects will take a long time.

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ECONOMIC CONSIDERATIONS

General Developments in 1966-67

30. Before considering the effects of the revised economic plan and the effect of the shift in priorities in favor of the military establishment, some discussion of the performance of the Soviet economy over the past few years is essential. Soviet gross national product (GNP) grew at an annual rate of nearly 6 percent during 1966-67, somewhat faster than the average of nearly 5 percent achieved during 1961-65 although still below the average for the 1950's (see Table 1). Most of the moderate acceleration in the rate of economic growth in 1966-67 is attributable to the above-average performance of agriculture. The Soviet

Table 1

USSR: Average Annual Rate of Growth
in Gross National Product and Its Components
1951-70

	Percent <u>a/</u>				
	<u>1951-60</u>	<u>1961-65</u>	<u>1966</u>	<u>1967 b/</u>	<u>1966-70 Plan</u>
Gross national product	6.7	4.8	7.8	3.8	6.0
Agricultural output	4.1	3.0	10.9	-3.4	4.7
Industrial output	9.7	6.5	7.5	8.5	8.3 <u>c/</u>
Other <u>d/</u>	7.2	5.4	5.9	6.3	6.3 <u>c/</u>

a. Unless otherwise noted, all data are CIA estimates.

b. Preliminary.

c. Mid-point of Soviet official plan range.

d. Construction, transportation, communications, and services.

Union harvested a bumper crop in 1966 and also benefited from better than average weather in 1967. The rate of growth of industrial production increased moderately in both years, spurred by sharp increases in raw materials from agriculture. The improved performance of the Soviet economy in 1966-67 reflects a sharp increase in productivity

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because inputs of labor and capital continued to increase at about past rates.

31. A rising share of the increase in GNP was allocated to defense. Consumption also may have increased somewhat faster than GNP. Investment, the touchstone for future economic growth, seems to have been the residual claimant in these two years.

Agriculture Yields Priority to Defense

32. Planned agricultural investment is likely to be one of the first victims of increased military spending. Net agricultural output increased an average of 3.5 percent per year in 1966-67, largely because of favorable weather. Although this rate was better than the annual average of 3 percent in 1961-65, it was well below the rate of growth achieved during the 1950's as well as the rate set in the plan for 1966-70. Total grain production is estimated at about 140 million metric tons in 1966 and about 115 million to 120 million metric tons in 1967. Average yields of grain per acre increased sharply in 1966 and fell back in 1967. The above-average grain crops permitted rapid growth in the output of meat, milk, and other livestock products, which increased 7.4 percent per year in 1966-67, three times as fast as in 1961-65, and also allowed grain stocks to be rebuilt. Consequently, the USSR did not have to use its scarce reserves of gold and hard currency to purchase large emergency wheat imports, as in 1963-65.

33. The success in agriculture apparently has led to a significant cutback in prior plans for 1966-70 to allocate large additional investment resources to that sector. Shaken by the grim necessity to import large quantities of wheat in the early 1960's, the regime had incorporated in the Plan Directives for 1966-70 large increases in machinery deliveries above those of 1961-65, a doubling of the output of mineral fertilizer, and the irrigating and draining of more than 20 million acres of land. These plans are far behind schedule (see Table 2). Deliveries of tractors and trucks to the farms increased by 15.7

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percent and 51 percent, respectively, in 1966; the number of new tractors scarcely increased at all in 1967; and the number of trucks actually declined by 13 percent. Even more significant, however, deliveries of agricultural machinery increased slightly in 1966 but not at all in 1967.

34. Deliveries of mineral fertilizer increased in 1966 and 1967, and this contributed significantly to the growth in agricultural output. The fertilizer program is more nearly on schedule than other major agricultural programs, but the 1968 plan calls for an increase in mineral fertilizer of only one-half the average rate achieved in 1966-67. The reclamation of land is proceeding at less than two-thirds of the rate required to meet the 1966-70 plan. Five million acres of land were reclaimed in 1966-67, but half that amount of land was withdrawn from use in 1966 and additional amounts probably were withdrawn in 1967.

35. Two other elements of the agricultural program -- a greater role for private activity and greatly increased monetary incentives -- have been carried out in varying degrees and probably contributed to the agricultural success in 1966-67. Following the lifting of Khrushchev's restrictions, private holdings of land and livestock increased markedly in 1965 and also slightly in 1966-67. Private plots and livestock holdings account for a large percentage of the output of meat, milk, eggs, and vegetables, which grew particularly rapidly in 1966-67. In view of the small expansion in the private sector in 1966-67, however, the regime apparently does not intend to rely on the private sector for additional food supplies.

36. With respect to incentives, special bonuses of 50 percent were provided for above-plan deliveries of grain in 1966-67, wages were raised on state farms in 1967, and other benefits were provided. As a result, cash and in-kind earnings of collective farmers from the socialized sector rose 16 percent in 1966 and about 4 percent in 1967. Wages of workers on state farms rose about 7 percent in 1966 and again in 1967. The percentage increase in incomes of farmers in these two years was more than double that of non-agricultural employees.

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Table 2

USSR: Planned and Actual Flow
of Resources to Agriculture
1966-70

	<u>1966</u>		<u>1967</u>		<u>1968</u>	<u>1966-70</u>
	<u>Plan</u>	<u>Actual</u>	<u>Plan</u>	<u>Actual</u>	<u>a/</u> <u>Plan</u>	<u>Plan</u>
<u>Machinery deliveries</u>						
	Average Annual Rate of Growth (Percent)					
Tractors	9.8	15.7	3.6	0.4	10.4	13.7
Trucks	85	51	41.5	-13.2	79.3	40.9
Other agricul- tural machinery	N.A.	3.6	11.6	0	19	13
<u>Land reclamation program</u>						
	Million Acres					
Gross additions to irrigated and drained area	2.5	2.8	2.4	2.4	2.8	21 to 23
	Average Annual Rate of Growth (Percent)					
<u>Mineral fertilizer deliveries</u>	9	12.8	5	9.4	5.4	15.2

a. Preliminary.

37. The agricultural successes of 1966-67 apparently have resulted in major foot-dragging and large cutbacks in Brezhnev's many-faceted program "to get agriculture moving again." Historically, investment commitments to agriculture have provided a ready source of cutbacks when crops happen to be large, for other claims on resources always seem urgent. Another cycle of complacency may be in the offing. In any event, the regime

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cannot count exclusively on above-average weather plus rubles in the hands of the peasants to cure the chronic ills of Soviet agriculture.

Rapid Pace in Industry

38. Industrial production in 1966-67 grew at an annual rate of 8 percent, considerably above the 6.5 percent average annual rate for 1961-65 but well below the average of the 1950's. Except for electric power, iron ore, pig iron, and some chemicals, output of major industrial commodities was approximately on schedule.

39. Contrary to hallowed Soviet doctrine about the primacy of heavy industry, production of consumer goods -- both durables and non-durables -- increased at approximately the same rate as the output of producer goods, and in 1968 the former is actually planned to exceed the latter. The only previous similar occurrence was in 1953-54, following the death of Stalin early in 1953, and was abruptly reversed with Malenkov's fall from power in 1955. The especially rapid rise in the output of the light and food industries was made possible by the sharply increased availabilities of agricultural raw materials resulting from the bumper harvest in 1966. Indeed, the growth of these industries accounts for almost one-half of the acceleration in overall industrial growth.

40. Two notable developments characterized machinery output in 1966-67. First, unlike the recent past, the rate of growth of military-oriented machinery in these years was much more rapid than that of civilian machinery (see Table 3). Second, also in sharp contrast to past practice, the consumer durables component of civilian machinery increased far more rapidly than the producer durables component. Output of consumer durables rose about 12 percent per year in 1966-67, whereas producer durables grew only 5 percent per year. These two developments mean that a greatly increased share of machinery output in 1966-67 was diverted from investment purposes to military and consumption purposes.

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41. The moderate acceleration in industrial growth in the past two years reflects increased productivity. Inputs of labor and capital (plant and equipment) grew a bit slower than in 1961-65, but their productivity doubled. The annual gain of 3 percent during 1966-67, however, is still far below the rate planned for 1966-70 and that actually achieved during the 1950's.

42. Several factors account for the sharp rise in the growth of productivity. Possibly the most important factor was the much greater availability of agricultural raw materials, permitting the fuller use of available plant capacity in consumer industries. Another factor was the bringing of actual operating capacities nearer to those planned in a number of major industrial plants. Many plants producing civilian goods were hastily built and prematurely commissioned during the latter years of Khrushchev's regime. Finally, the economic reform currently being carried out in industry probably also made some contribution to productivity, particularly in 1967. The reform, which gears monetary incentives more closely than before to enterprise efficiency, affected only about 700 plants in 1966, but by August 1967 it affected 5,500 plants, which accounted for a third of total industrial output. Plants under the reform are reported to have done better than industry as a whole in increasing sales, profits, and productivity. Soviet sources, however, repeatedly attribute the initial successes to one-time factors, such as the using up of excess stocks of products and materials.

Shortfalls in Agricultural and Industrial Investment

43. Although data are meager and ambiguous, the growth rate of aggregate investment in 1966-67 apparently was higher than that of 1961-65 but well below the rate of the 1950's. Nevertheless, investment in the two key sectors of agriculture and industry is well behind plan. In 1966-67, investment in agriculture increased at only about one-half of the planned rate, and all of the increase was devoted to land improvement and buildings; investment in machinery and equipment did not rise at all. Investment in industry increased only about 4.7 percent in 1966 and probably somewhat faster in 1967.

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Table 3

USSR: Average Annual Rate of Growth
in the Allocation of Machinery a/
1961-70

						Percent
	<u>1961-65</u>	<u>1966</u>	<u>1967</u>	<u>1966-67</u>	<u>Original 1966-70 Plan</u>	
Total machinery	7.4	9.7	7.2	8.4	10 to 11	
Of which:						
Military	3.5	13.6	8.9	11.2	8.5 to 12	
Civilian	10.3	7.2	6.2	6.7	11	
Of which:						
Equipment for investment	10.4	5.4	4.7	5.0	10.5	
Consumer durables	10.1	13.2	10.8	12.0	13.0	

a. Data on performance in 1961-67 are CIA estimates. Figures for the 1966-70 plan are CIA calculations based on Soviet plan announcements.

44. The slowdown in the rate of growth of industrial investment resulted in a drop in the rate of growth of capital stock (plant and equipment) in 1966-67 from an average of 11 percent in 1961-65 to 8.5 percent in 1966 and to probably an even lower rate in 1967. Agricultural plant and equipment increased 10 percent per year during 1961-65 and 7 percent in 1966. In both sectors the rate of growth of capital stock probably achieved in 1966-67 falls far short of the rates projected in the 1966-70 plan. In the face of a declining rate of investment in 1961-65, the previous rate of growth of capital stock was maintained by deferring the retirement of obsolete plant and equipment. These opportunities clearly are nearing exhaustion.

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Improvements in Consumer Welfare

45. Soviet consumers fared exceptionally well in 1966-67. Real income per capita, which includes wages, farm incomes in kind, and payments from the state budget, rose nearly 6 percent per year, compared with about 3.5 percent in 1961-65. Thanks primarily to the good crop years, per capita consumption of goods and services in 1966-67 rose almost as fast as real incomes -- about 5.5 percent annually, double the rate in 1961-65. Much larger supplies of meat, dairy products, and vegetables were available, significantly improving the quality of the diet, which has long consisted mainly of bread and potatoes.

46. Clothing supplies also increased markedly, and their quality was better, thanks in part to unprecedentedly large imports from the West, which are estimated to amount to \$100 million in 1967. Such imports were insignificant in the past. Consumer durables, particularly television sets, refrigerators, and washing machines, were also available in much greater quantities; production of consumer durables rose about 12 percent per year in 1966-67, double the rate of increase in 1961-65. On the other hand, services improved only slightly. Plans for housing construction were greatly underfulfilled as usual, and per capita housing space increased by a mere 0.2 meter.

47. Despite the increased flow of consumer goods, inflationary pressures grew stronger in 1966-67. Considerable inflationary potential already existed in the economy as a result of past policies which provided large quantities of rubles unmatched by goods and services. Per capita disposable money income rose more than 7.5 percent per year, much faster than the 5.2 percent called for in the 1966-70 plan and considerably faster than consumption of goods and services. As in the recent past, a substantial part of the excess purchasing power was absorbed in voluntary savings; savings bank deposits increased about 20 percent per year in 1966-67. This means, however, that the people expect housing and durable goods to be made available in the future.

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Adjustments in Overall Targets for 1968-70

48. Although the increase of 2.2 billion rubles in the announced defense budget for 1968 has drawn the most attention, the plan and budget announcements contain other indications of increased emphasis on military programs in 1968-70. First, Baybakov reaffirmed the original goals for a major increase in national income and industrial production in 1966-70. At the same time, a number of the original 1970 goals in key nonmilitary areas were pared back (see Table 4). Either the original

Table 4

USSR: Revision of 1970 Plan Goals

	Unit	Original 1970 Goal	New 1970 Goal
National income <u>a/</u>	1955 = 100 (index)	138 to 141	139
Industrial production	1965 = 100 (index)	147 to 150	149 <u>b/</u>
Individual products			
Oil	Million metric tons	345 to 355	350
Natural gas	Billion cubic meters	225 to 240	215
Electric power	Billion kilowatt- hours	830 to 850	807
Steel	Million metric tons	124 to 129	124
Fertilizer	Million metric tons	62 to 65	62
Plastics and resins	Million metric tons	2.1 to 2.3	1.8
Chemical fibers	Thousand metric tons	780 to 830	707
Motor vehicles	Million units	1.36 to 1.51	1.36

a. Soviet concept, which excludes services.

b. CIA calculation from Soviet announcements.

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goals are reduced (natural gas, electric power, plastics and resins, and chemical fibers) or the new 1970 goals are set at the lower limits of the ranges originally set out by Kosygin in 1966 (steel, motor vehicles, and fertilizer).

49. Not only have production goals been cut back in certain major sectors of industry, but also investment goals for those sectors are lower than those originally set for 1970. The concentration of the cutbacks outside of the military-oriented machinery industry, coupled with the reaffirmation of the target for industrial production as a whole, suggests a plan revision that would accommodate a boost in military expenditures above levels previously planned.

50. The Soviet planners seem to have sketched out a pattern of industrial development during 1968-70 in which production of some key industrial commodities and investment goods -- such as steel, electric power, and synthetics -- grow at slower rates than originally planned, permitting the military-oriented sectors of industry to grow at more rapid rates. Information available on 1968-70 does not permit the separating out of planned rates of growth for producer durables and military equipment. Only a qualitative judgment can be made that the pattern of 1966-67 will continue into 1968-70.

Brezhnev Agricultural Program a Casualty

51. As in 1966 and 1967, ambitious plans have again been announced for the production or delivery of major categories of equipment to agriculture. Because of the lackluster record in this area in 1966-67, it is believed that the 1968 target probably will not be met. The rate of increase of deliveries of fertilizer to the farms is set in 1968 at only one-half the rate achieved in 1966-67. The increase in investment in agricultural machinery and equipment in the revised 1966-70 plan may be as much as one-third less than in the original plan. In any event, unless there are unexpected and spectacular boosts in the allocation of resources to agriculture in 1969 and 1970, the initial targets for investment in agricultural equipment and land reclamation as well as for deliveries of fertilizer will be seriously underfulfilled.

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52. The sag in the Brezhnev program for investment in agriculture may have been agreed on because of the good-to-excellent harvests of 1966 and 1967. Enhanced monetary incentives to farm workers had a role in these successes, and the Soviet leaders could have believed that these incentives were a happy substitute for the commitment of investment resources. It is easy to imagine that the suddenly improved agricultural situation -- allowing the accumulation of some grain stocks -- provided the military leaders with an excellent talking point in any plan for a larger defense budget; at the same time, it is doubtful that agricultural plans were cut without a sharp battle at the highest political level. In any case, the 1966-70 goals for agricultural production cannot be met cheaply; investment in real resources will have to be revived if the goals are to be realized.

Plans for Consumer Welfare

53. The single clear feature of the 1968 and 1969-70 plans in the area of consumption is the announced rise in money incomes of the population. Measures to be carried out in 1968 are to add 6 billion rubles to cash incomes. Per capita real income is scheduled to increase by 7 percent per year.

54. In part, the increases in incomes stem from a wage creep associated with rising labor productivity and normal higher growth in welfare payments in the form of pensions and other transfer payments. Nevertheless, the planners are carrying out a series of wage and welfare reforms which could have been postponed. For example, in 1968 (a) minimum wages of the state labor force will increase to 60 rubles a month, from 40 rubles in rural areas and 45 rubles in urban areas; (b) geographic differentials in earnings for workers in remote areas will rise; (c) collective farmers will be allowed to retire five years earlier; (d) one-third of the state labor force will receive longer vacations; (e) workers making 60 to 80 rubles a month will pay less income tax; and (f) veterans' disability pensions and sick pay allowances will increase. Over and above these measures, which benefit primarily the most distressed parts of the population, 1½ million

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machine tool operators will receive a 15-percent hike in pay.

55. What the new plans for 1968-70 do not say is how goods and services are to grow to meet the swelling consumer demand. As incomes increase, the demand for more and better quality goods is bound to become more insistent. The 1968 plan suggests, however, that the regime does not intend to make any appreciable adjustments in the original five-year-plan directives in the area of consumption. Where 1970 goals for consumer durables were given in the new 1969-70 plan, they stayed at the levels set out in the original plan for 1970. Despite the publicity given to plans for production of passenger cars, the USSR is barely at the threshold of the automobile age. Nor will the consumer demand be accommodated by a long-desired increase in the supply of housing. The new goal for housing construction in 1966-70 is 3 percent less than the target carried in the original plan.

56. The output of consumer goods in industry in 1968 is to grow at a higher rate than other industrial production -- 8.6 percent, compared with 7.9 percent. It must be remembered that previous attempts to close the gap between rates of growth of consumer goods and producer goods foundered. The same elements that contributed to previous failures are present now -- (a) plans depend on an unreasonably high assumption about the receipts by consumer industry of agricultural raw materials, and (b) with investment being pressed down, plans for expanding and renovating consumer industry will be the first to be jettisoned.

Economic Perspective: Two Risks

57. The increased allocation of resources to the military will accentuate the current slowdown in the flow of new industrial investment and will force the USSR to operate an industrial plant that is growing older and more obsolescent. Therefore, (a) technology will lag, (b) repair bills will mount, and (c) a growing fraction of output will be below world standards. The leadership is taking a major risk in diverting investment resources to military use when these resources may be vital to

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maintaining the long-term quality of the industrial plant.

58. In similar fashion, Soviet agriculture in most years carries out its basic task of providing sufficient calories for the population but needs to move to a higher level of organization, technology, and diversity of output. Greatly increased production of meats and other quality foods requires a large sustained investment in agriculture. This investment, which is a necessary but not a sufficient condition for growth, was provided for in the Brezhnev program. The substantial cuts in this program represent the second major risk taken by the leadership -- namely, that future gains in agricultural production are made more precarious.

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